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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 696

In the Matter

of

GODFREY-KEELER CO., INC., Debtor,
Petitioner,

—against—

THE WICKES BOILER COMPANY, INC.,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS, FOR THE SECOND CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

JACOB LEVINE,
Counsel for Petitioner.

THE COURT PRESS, N. Y. C.

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—against—

THE WICKES BOILER COMPANY, INC.,

Respondent.

Petition for Writ of Certiorari to the Circuit Court of Appeals, for the Second Circuit.

Petitioner respectfully prays that a writ of certiorari issue to review an order of the Circuit Court of Appeals, for the Second Circuit, reversing upon reargument a previous decision by the said Court, and affirming by a unanimous court an order of the United States District Court, for the Southern District of New York, which order affirmed an order of the Referee.

Opinions Below.

The opinions of the District Court and Referee are not officially reported. The first opinion of the Circuit Court of Appeals is reported in 116 F. (2d)

842. The opinion of the Circuit Court of Appeals, on reargument, is reported in 121 F. (2d) 415. Both opinions of the Circuit Court of Appeals were written by Judge Augustus N. Hand.

Jurisdiction.

The order of the Circuit Court of Appeals was entered on the 12th day of July, 1941 (R., p. 61). The jurisdiction of this court is invoked under §240 (a) of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C. A. §347).

Questions Presented.

The questions presented are:

(1) Is §36a of the New York Lien Law a penal or substantive statute creating a civil right and remedy;

(2) If substantive, may a trust be impressed for the benefit of a materialman creditor, where the creditor has failed to file a mechanic's lien within the statutory filing period and the monies sought to be impressed with a trust are received by the trustee in bankruptcy as distinguished from the original "contractor";

(3) Does §36a of the New York Lien Law create a class of creditors who, in effect, would be entitled to priority in contravention of §64 of the Bankruptcy Act.

Statutes and General Orders Involved.

The statutes involved are 64 of the Bankruptcy Act, which by the 1938 amendment eliminated certain

state priorities, and 36a of the New York Lien Law, which provides:

> "§36-a. CONTRACTOR WHO DIVERTS FUNDS GUILTY OF LARCENY. The funds received by a contractor from an owner for the improvement of real property are hereby declared to constitute trust funds in the hands of such contractor to be applied first to the payment of claims of subcontractors, architects, engineers, surveyors, laborers and materialmen arising out of the improvement, and to the payment of premiums on surety bond or bonds filed and premiums on insurance accruing during the making of the improvement and any contractor and any officer, director or agent of any contractor who applies or consents to the application of such funds for any other purpose and fails to pay the claims hereinbefore mentioned is guilty of larceny and punishable as provided in section thirteen hundred and two of the penal law."

Statement.

In May 1938, petitioner, Godfrey-Keeler Co., Inc., entered into a contract with the Brooklyn Yarn Dye Company to install a power plant and heating system in the premises of the latter. Contemporaneously, petitioner, as contractor, entered into subcontracts with the respondent, The Wickes Boiler Company, Inc., whereby the latter agreed to furnish boilers and insulating panels for the heating system (R., fols. 10-11). Thereafter, on November 1st, 1939, petitioner filed a petition for an arrangement under Chapter XI of the Bankruptcy Act and an order was made continuing the Debtor in possession (R., fol. 13).

The respondent never filed a mechanic's lien and its time to do so had expired when the Debtor filed its petition for an arrangement (R., fol. 62).

The respondent was named in the schedules as an unsecured creditor for $1810.50 (R., fol. 12).

On November 14th, 1939, the respondent instituted this proceeding before the Referee to strike its name from the schedules of unsecured creditors and to impress a trust pursuant to §36a of the New York Lien Law on the monies to be thereafter payable by Brooklyn Yarn Dye Company (R., fols. 6-8). The Referee granted the application and impressed a trust in favor of the respondent (R., fols. 59-80).

Upon petition to review to the District Court, the Referee's order was affirmed (R., fols. 88-96). The Debtor appealed, as of right, to the United States Circuit Court of Appeals, for the Second Circuit, which Court, by opinion dated December 24th, 1940, reversed the order of the District Court and dismissed the petition of the respondent.

Thereafter, a motion for re-argument was granted, and by order dated July 12th, 1941, the Circuit Court of Appeals reversed its former decision and affirmed the order of the District Court.

Specification of Errors To Be Urged.

The Court below erred

(1) In refusing to hold that §36a of the New York Lien Law is a penal statute;

(2) in holding that the trust arose where the funds are received directly by a trustee in bankruptcy as distinguished from the contractor;

(3) in holding that the trust arose in favor of a materialman who had failed to file a mechanic's lien within the statutory period; and

(4) in holding that §36a does not contravene §64 of the Bankruptcy Act.

Reasons for Granting the Writ.

The decision by the Circuit Court in the present case is in direct conflict with the holding of the Circuit Court of Appeals, Sixth Circuit. The latter Court, in *Edward Misch Co.'s Estate,* 112 F. (2d) 1007, aff'g 34 F. Supp. 781, affirmed an order of the Referee denying an identical application by a materialman creditor. There, too, the application to impress a trust was based upon a state statute of Michigan similar to §36a of the New York Lien Law. The Court there, in refusing to impress a trust, held that the state statute was exclusively penal.

Statutes similar in purpose to §36a of the New York Lien Law have been enacted in

Arkansas	Minnesota	North Carolina
Kentucky	Nebraska	South Dakota
Michigan	Wisconsin	Ohio

The final determination as to whether such a statute is penal or substantive thus creating civil rights and remedies, is of major importance to the administration of the bankrupt estates of contractors. The determination of that question by this Court will definitely establish and limit in insolvency proceedings the property rights of materialmen and subcontractors claiming to be beneficiaries of trust statutes.

Conclusion.

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be granted.

Respectfully submitted,

GODFREY-KEELER CO., INC.,
by JACOB LEVINE,
Counsel for Petitioner.

BRIEF IN SUPPORT OF PETITION.

Argument.

POINT I.

Section 36a of the New York Lien Law creates a particular statutory crime; it does not create new civil rights or remedies between a contractor and his materialmen.

This Court has held that the question as to whether a state statute is penal or not is one exclusively within the determination of the Court in which the action is then pending. Thus it was said in *Huntington* v. *Attrill,* 146 U. S. 657, at page 683:

> "In this country, the question of international law (is the law penal?) must be determined in the first instance by the court, state or national, in which the suit is brought. If the suit is brought in a Circuit Court of the United States, it is one of those questions of general jurisprudence which that court must decide for itself, uncontrolled by local decisions. *Burgess* v. *Seligman,* 107 U. S. 20, 33; *Texas & Pacific Railway* v. *Cox,* 145 U. S. 593, 605."

In accordance with the foregoing rule, petitioner presented to the Court below the question whether the New York statute was a penal statute and, therefore, not entitled to recognition or enforcement. The opinions of the Circuit Court contain no reference to this point, and no direct ruling was made thereon.

The precise question, however, was passed upon by the Circuit Court of Appeals, Sixth Circuit, in *Edward Misch Co.'s Estate,* 112 F. (2d) 1007, affirming 34 F. Supp. 781. There, a materialman sought to impress a trust on funds in the hands of the trustee in bankruptcy, pursuant to the Public Acts of Michigan, 1931, No. 259. The Michigan statute provided

> "Building contract fund; status as a trust fund. Section 1. In the building construction industry, the building contract fund paid by the owner to a contractor, or by the owner or contractor to a subcontractor, shall be considered by this act to be a trust fund, for the benefit of the owners, contractors, laborers, subcontractors or materialmen, and the said contractor or subcontractor shall be considered the trustee of all funds so paid to him for building construction purposes.
>
> same; fraudulent detention or use by contractor or subcontractor, penalty. sec. 2. Any contractor or subcontractor engaged in the building construction business, who, with intent to defraud, shall retain or use the proceeds or any part therefor, of any payment made to him, for any other purpose than to first pay laborers, subcontractors and materialmen, engaged by him to perform labor or furnish material for the specific improvement, shall be guilty of felony in appropriating such funds to his own use while any amount for which he may be liable or become liable under the terms of his contract for such labor or material remains unpaid, and may be prosecuted * * * and upon conviction shall be punished by a fine * * * or * * * imprisonment * * * at discretion of the court."

In refusing to impress a trust, the Referee held that the Michigan statute was a penal one and did

not confer any civil rights or remedies. The determination of the Referee was affirmed unanimously by the Circuit Court of Appeals, Sixth Circuit.

A comparison of the Michigan statute with the New York statute indicates a complete similarity, except for phraseology. Both statutes declare the funds received by a contractor to be trust funds. Both require the contractor to pay the funds to his subcontractors and materialmen. Both likewise provide that a failure by the contractor to comply with the provisions of the statute constitutes a felony. Between the two statutes, there are more indications for holding the granting of a civil right or remedy under the Michigan statute, than under the New York statute. The New York statute consists of one sentence, containing two separate thoughts. The first declares the funds received by a contractor to be trust funds to be applied to the payment of materialmen and subcontractors; the second provides that any failure by the contractor to so apply the funds shall constitute a larceny. In the Michigan statute, these two thoughts are expressed as separate sections, numbered 1 and 2, consecutively. Standing alone, §1 clearly creates a civil right and remedy. Notwithstanding, such subdivision the Michigan Court held that the statute did not affect the civil rights and obligations existing between the contractor and his subcontractors or materialmen, but on the contrary, solely created a particular statutory crime. *Club Holding Co.* v. *Flint Citizens Loan & Investment Co.*, 272 Mich. 66, 261, N. W. 133. So too, in *Raymond Concrete* v. *Federation Bank & Trust Company*, 261 App. Div. 25, Dore, *J.*, in a dissenting opinion, held that §25a of the New York Lien Law (which is identical with §36a except that it applies to public im-

provements) was likewise penal in nature and punitive in character.

Further basis for the petitioner's contention that the New York statute was intended to create a new statutory crime is found in the report of the New York State legislative committee, when in 1930, it recommended an amendment to §25 of the Lien Law. The proposed amendment was the exact counterpart of §36a, except that it applied to public improvements. In proposing this amendment, the committee stated (Legal Document No. 72, 1930, Vol. 19, p. 23):

> "In order to strengthen the law the committee further recommended the penalty provided in subdivision (6) thereof, thus bringing the diversion of funds under this section in line with similar provisions contained in sections 36, 36a and 36b relating to diversion by an owner, contractor and subcontractor of funds on private improvements."

And, again, the same committee, in proposing 36a and 36b, said, at page 26:

> "Your committee in recommending the change from misdemeanor to larceny believes that in order to give proper protection against misapplication of funds, the law should be severe enough to be a real deterrent."

Nothing the committee could have said could have more adequately expressed their intention that the statute was penal than the expression "the law should be severe enough to be a real deterrent."

As a penal statute, the New York statute is complete. As a statute granting a civil right or remedy, as contended by the respondent herein, there is no

explanation for the following self-evident defects in the statute, if it be construed as granting civil rights:

The statute permits the contractor full freedom to enter into any compromise or settlement with the owner of the improvement, without consulting with the intended beneficiaries of the trust;

the statute permits the contractor to assign the trust funds without the consent of the intended beneficiaries. *Amiesite Construction Corp.* v. *Luciano Contracting,* 284 N. Y. 223;

the statute permits a judgment-creditor of the contractor to levy upon or attach the funds while in the hands of the owner of the improvement, *Amiesite Construction Corp.* v. *Luciano Contracting* (*supra*);

the statute permits the contractor to distribute the funds in any proportion he sees fit to the intended beneficiaries, instead of pro rata.

The foregoing deficiencies are such as to completely nullify any benefits that might have been intended by the statute were it designed to create civil rights. There is neither basis nor reason to assume that the legislators allowed these patent defects to exist if it were their intention to draft a statute conferring civil rights and remedies. The existence of these defects is only consonant with a finding that the statute was intended solely and exclusively as one creating a statutory crime.

The fact that the Courts of New York have given effect to this statute as one granting civil rights is not binding or controlling upon this Court, *Huntington* v. *Attrill* (*supra*).

POINT II.

The trust as intended by Section 36a of the New York Lien Law does not arise until, as a condition precedent, the funds come into or pass through the hands of the contractor.

Unlike similar statutes enacted in several of the other states, the New York statute specifically limits the trust to "funds received by a contractor * * * and * * * funds in the hands of such contractor."

At the time when this appeal was first submitted to the Circuit Court, there had as yet been no ruling by the Court of Appeals of the State of New York as to the scope of the foregoing phrase. There were, however, decisions of lower Courts which were submitted to the Circuit Court. The general tenor of these decisions was that none other than the contractor could be included in the *descriptio personae* under the various trust sections of the Lien Law. The Circuit Court, in its first opinion in this case, sought to distinguish these decisions on the ground that if the party receiving the funds had notice that it was a recipient of trust funds then such party was within the *descriptio personae* of the statute.

Subsequently, the question was presented to the Court of Appeals by the appellant in *Amiesite Construction Corp.* v. *Luciano Contracting* (*supra*). In that case, the appellant, a subcontractor who had failed to file a lien, was contesting the rights of the assignee of the general contractor to the funds in the possession of the state. It was argued by the appellant that by reason of §25a of the Lien Law, a trust was imposed on the funds for the primary benefit of the appellant as an unpaid subcontractor. (§25a, ap-

plicable to public improvements, is the exact counterpart of §36a, applicable to private improvements.) It was also stated by the appellant, and conclusively established in the record on appeal, that the assignee had notice that he was to be the recipient of trust funds and, it was argued, the assignee was, therefore, within the *descriptio personae* of the statute. In overruling both arguments the Court of Appeals said, page 225:

> "At the time of the commencement of this action there was a balance due and unpaid to the contractor in the amount of $4,802.90. Those monies were not in the hands of the contractor. Neither were they set aside and appropriated to the contract by the State."

Pages 226-227:

> "* * * Plaintiff alleges * * * it must be given preference * * * on the theory that the balance unpaid constitutes a trust fund in the hands of the State exclusively for the benefit of laborers and materialmen and others specified therein as against such an assignment. We agree with the lower courts that plaintiff cannot maintain its claim."

Pages 228-229:

> "* * * It was a valid common-law assignment and, as such, it gave Fiore preference over the plaintiff in the distribution of the unpaid balance due to the contractor upon completion of the improvement contract since the plaintiff had neither a prior nor subsequent valid lien (cases cited)."

Since the Court of Appeals sustained the validity of the assignment in spite of the knowledge of the

assignee that he was to be the recipient of trust funds, it is obvious that such knowledge by a recipient is immaterial if the funds are received by the recipient directly from the owner of the improvement as was the fact in the *Amiesite* case. If that were not the intention of the Court of Appeals, there would have been no necessity for the Court to emphasize the fact that the funds were not in the possession of the contractor, by its statement, "those monies were not in the hands of the contractor".

Petitioner therefore submits that since a trustee is not specified in the *descriptio personae* of the statute, he is not bound by the trust provisions thereof when, as in this case, the funds are to be received by the trustee in bankruptcy, rather than the contractor. It is not a sufficient answer to state that a trustee is vested with no greater interest than the bankrupt himself, as was said by the Circuit Court in its first opinion. That argument is rendered ineffective by the analogous situation of a conditional vendor who has failed to file a copy of his contract, as required by the New York Law. As between that conditional vendor and his purchaser, the reservation of title is valid. As between the conditional vendor and a trustee in bankruptcy of the purchaser, the reservation of title is invalid and will not be given effect. The result has been justified by reason of the Bankruptcy Act, which affords the trustee the rights of an attaching or judgment creditor. Such a creditor would have paramount rights, even under the decision of *Amiesite Construction Corp.* v. *Luciano Contracting Co.* (*supra*), for the court, there, took the pains to point out, at page 226: "Plaintiff was neither a judgment creditor nor an attaching creditor." The inference is that if the plaintiff were such a creditor, the

court would have held in its favor. The debtor as Trustee, is entitled to the same rights as an attaching or judgment creditor.

POINT III.

Section 36a of the New York Lien Law should not be invoked for the benefit of a materialman creditor who has failed to file a lien within the statutory period.

In its first opinion reversing the District Court, the Circuit Court relied upon a decision of the Appellate Division, Second Department, in *New York Trap Rock Corp.* v. *National Bank of Far Rockaway,* 260 App. Div. 1035, aff'd 285 N. Y. 313, wherein that Court held that the funds received by a contractor do not acquire the character of trust funds unless and until a lien is filed. Subsequently, the case was affirmed by the Court of Appeals on procedural grounds, leaving for future determination the construction and effect of the trust section involved. Because of the refusal by the Court of Appeals to pass upon the Appellate Division's construction of the statute, the Circuit Court reversed its former decision upon the reargument.

Up to the present time, there has been no ruling by the Court of Appeals on this question. However, the question was presented to the Supreme Court of Wisconsin in *Pauly* v. *Keebler,* 175 Wis. 428, 185 N. W. 554, a case involving a statute similar to §36a of the New York Lien Law.

The statute involved states:

> "All monies paid by the owner to the principal contractor shall be and constitute a trust

fund in the hands of such principal contractor, to the amount of all claims due from or owing by such principal contractor, for work, labor and materials or to become due from or owing by such principal contractor for such work, labor and materials to persons entitled to a lien under this chapter against said owner and his property until all such claims have been paid; the using of such moneys by such principal contractor for any purpose other than the payment of such claims, until all such claims, except those which may be in dispute, have been paid, is hereby declared to be an embezzlement of said moneys punishable as provided by law in case of embezzlement."

Referring to this statute, the Court states:

"As we construe the language of the statute, it refers to all persons who may be entitled to claim the benefit of the lien law, but it could hardly have been the legislative's intent that the clause in question should refer to those who have lost their right to claim a lien by neglecting to file any notice within the statutory period. Nor do we think the legislature could have intended that the clause should be construed so strictly as to include only those who had actually filed the notice of lien at the time of the diversion of the trust fund. Such a construction would enable a contractor to obtain money from the owner and misappropriate it before the time for filing notices had expired or before the amount due laborers or materialmen had been ascertained and thus the object of the statute would be defeated."

The interpretation placed upon the statute by the Wisconsin Supreme Court is logical and should be followed.

POINT IV.

In effect, Section 36a of the New York Lien Law grants priority to a class of creditors in contravention of Section 64 of the United States Bankruptcy Act.

Prior to the 1938 amendment, one of the subdivisions of §64 provided for priority on debts owing to a person who, by the laws of the state, was entitled to priority. The provision as to such debts was eliminated by the 1938 amendment.

The intent of Congress in enacting this amendment is expressed in the report of the House Committee on the Judiciary (report number 1409, 75th Congress), wherein it is stated:

> "Elimination of certain priorities: Section 64: Certain state priorities have been eliminated. The necessity for so doing is obvious; many estates have been consumed, to the exclusion of general creditors, by the ever increasing class of state priorities."

It was claimed by the petitioner in the Court below that the effect of §36a was to create a class of creditors entitled to priority in contravention of §64a, subdivision 5, of the Bankruptcy Act. The Circuit Court, in its first opinion, held that §36a did not alter the priorities fixed by §64, since the trust funds were not assets of the bankrupt's estate. No doubt, the Circuit Court was guided by the characterization of trust funds, as used in the statute. If such a characterization is sufficient to remove the funds of a bankrupt from the reach of his general creditors, there is nothing to prevent each state from enacting similar legislation to apply to each and

every industry that may be carried on in the several states. Consistency would demand that the Federal Courts recognize such statutes. The ultimate result would be to revive the very evil that Congress sought to eliminate by the amendment.

The characterization used in a state statute in and of itself should not be the determining factor, as was stated by this Court in *The City of New York* v. *Michael Feiring,* trustee in bankruptcy of National Studios, Inc., decided May 26, 1941. This Court, by Mr. Justice Stone, said:

> "Intended to be nationwide in its application, nothing in the language of §64 or its legislative history suggests that its incidence is to be controlled or varied by the particular characterization by local law of the state's demand. Hence we look to the terms and purposes of the Bankruptcy Act as establishing the criteria upon the basis of which the priority is to be allowed."

When subjected to the foregoing test, it is submitted that §36a contravenes the terms and purposes of the Bankruptcy Act.

CONCLUSION.

In order to resolve the conflict which now exists between the Circuit Courts for the Second and Sixth Circuits, it is respectfully submitted that the writ of certiorari should be granted.

Respectfully submitted,

JACOB LEVINE,
Counsel for Petitioner.

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ALFRED B. NATHAN,
Counsel for Respondent.

THE COURT PRESS, N. Y. C.

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BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

Statement.

This is an application for a writ of certiorari to the Circuit Court of Appeals for the Second Circuit. The Circuit Court decision of which petitioner complains, affirmed a decision of the District Court for the Southern District of New York, which in turn affirmed a decision of Hon. Irwin Kurtz, Referee in Bankruptcy.

The proceeding before the Referee was brought by The Wickes Boiler Company, Inc. under Section 36-a

of the Lien Law of the State of New York. Section 36-a provides as follows:

> "Sec. 36-a. Contractor who diverts funds guilty of larceny.
>
> The funds received by a contractor from an owner for the improvement of real property are hereby declared to constitute trust funds in the hands of such contractor to be applied first to the payment of claims of subcontractors, architects, engineers, surveyors, laborers and materialmen arising out of the improvement, and to the payment of premiums on surety bond or bonds filed and premiums on insurance accruing during the making of the improvement and any contractor and any officer, director or agent of any contractor who applies or consents to the application of such funds for any other purpose and fails to pay the claims hereinbefore mentioned is guilty of larceny and punishable as provided in section thirteen hundred and two of the penal law. Added L. 1930, c. 859, Sec. 18, eff. Oct. 1, 1930."

The petitioner Godfrey-Keeler Co., Inc. had installed a power plant and heating system in the premises of the Brooklyn Yarn Dye Company, at 24 Woodward Avenue, Brooklyn, New York (fols. 10, 60). The respondent, The Wickes Boiler Company, Inc. under a contract with the petitioner, had furnished the boilers for said power plant and heating system (fols. 11, 60). Godfrey-Keeler Co. Inc. then filed a petition for arrangement. At the time of the filing of the petition there remained due from Brooklyn Yarn Dye Company to petitioner on the principal contract a balance of about $8800 (fols. 12, 61-62),

and at that time there remained due from petitioner to respondent for its boilers a balance of $1,810.50 (fols. 12, 60).

Godfrey-Keeler Co. Inc., without paying the claim of The Wickes Boiler Company, Inc. and the other sub-contractors, laborers and materialmen on the Brooklyn Yarn Dye Company job, proposed to use the money to be received from the Brooklyn Yarn Dye Company to consummate its proposed arrangement with the general creditors (fols. 17, 18). To prevent this and to enforce the trust created by Section 36-a of the Lien Law, The Wickes Boiler Company, Inc. made an application before the Referee to impress a trust on the moneys due from the Brooklyn Yarn Dye Company. The application was granted and, as we have already pointed out, the Referee's decision has been sustained by the District Court and the Circuit Court. (To avoid confusion, we point out that in the proceeding before the Referee, The Wickes Boiler Company, Inc. was the petitioner, and is so referred to in the record. On the present application for a writ of certiorari, the Godfrey-Keeler Co. Inc. is, of course, the petitioner, and The Wickes Boiler Company, Inc. the respondent.)

POINT I.

There is no ground for granting certiorari.

The jurisdiction of this court is invoked under Subdivision (a) of Section 240 of the Judicial Code (Pet., p. 2). The sole reason urged by petitioner for the granting of the writ is an alleged conflict between the Circuit Courts for the Second and Sixth Circuits (Pet., p. 5).

There is no such conflict between the Circuits as warrants the granting of this application. Both Circuit Courts merely applied state law, and as to questions controlled by state law, a conflict among Circuits is not of itself a reason for granting a writ of certiorari.

Ruhlin v. *New York Life Insurance Co.*, 304 U. S. 202.

The principal case involved the construction and effect of Section 36-a of the Lien Law of the State of New York. The case of *Edward Misch Co.'s Estate*, 112 Fed. (2) 1007, aff'g 34 Fed. Supp. 781, in the Sixth Circuit, involved the construction and effect of Act 259 of Michigan Public Acts of 1931.

As petitioner itself recognizes (Pet.'s Brief, bottom of p. 11), the courts of New York give effect to Section 36-a as a civil statute creating substantive rights enforceable by the subcontractors and other beneficiaries named in the section. The Supreme Court of Michigan, on the other hand, has held that Act 259 of Michigan Public Acts of 1931 is purely a criminal statute and does not create substantive civil rights which the subcontractors and other beneficiaries of the trust can enforce. (*Club Holding Co.* v. *Flint Citizens' Loan & Investment Co.*, 272 Mich. 66, 261 N. W. 133.)

The Federal Courts in the Second Circuit applied the law of New York in determining the construction and effect to be given to Section 36-a of the Lien Law of the State of New York, and the Federal Courts in the Sixth Circuit applied the Michigan law in determining the construction and effect to be given to Act 259 of Michgan Public Acts of 1931. Surely, it

is not the province of this court to tell the Legislatures of New York and Michigan what statutes to enact, nor to direct the courts of New York and Michigan as to the interpretation to be given to the statutes of their respective states.

Petitioner seeks to persuade this Court that the federal courts in the principal case and in the *Edward Misch Co.* case were not applying state law. Then what law were they applying? Is it seriously contended that there is a body of federal law governing the interpretation of the Lien Statutes of New York and Michigan?

Petitioner relies on *Huntington* v. *Attrill*, 146 U. S. 657, which has no application whatever. In that case it was sought to enforce a New York statute in a Maryland court, and it was contended that the Maryland court did not have to enforce the statute because that would be giving effect to the Penal Law of another state. This court pointed out that the question presented was "whether this statute is a Penal Law in the international sense" (p. 679). In other words, the Maryland court was required to determine whether, under the rules of international law, it should take jurisdiction of the case. Such a question might have been determinable by the law of the forum. But even then, the law of the forum would apply only to the jurisdictional question. Once the court determined to take jurisdiction, its decision as to the construction and effect of the statute would be governed by the law of the enacting state.

Of course, no question of jurisdiction or international law was presented either in the principal case or in the *Misch Co.* case. The Wickes Boiler Company in the principal case and the R. C. Mahon

Company in the *Edward Misch Co.* case applied to the federal courts for the purpose of having trusts imposed on certain moneys coming into the hands of trustees in bankruptcy. The relief sought was purely civil. The criminal aspects of the statutes were not involved at all, and these were not cases of courts being asked to enforce the Penal Laws of foreign jurisdictions.

The question whether the statutes were purely penal or whether they also created substantive rights, was considered solely for the purpose of determining the merits of the controversy, viz., whether the petitioning subcontractors had enforcible claims as trust beneficiaries. The question was entirely one of statutory construction determinable by state law. As the District Court pointed out in the *Edward Misch Co.* case:

> "It appears to this Court that the construction placed upon the statute in question by the Michigan Supreme Court in the case of *Club Holding Company* v. *Flint Citizens' Loan & Investment Company* reported in 272 Mich. 66, 261 N. W. 133 is conclusive upon the question. In passing upon a State statute, this Court is constrained to give effect to the same in harmony with the decisions of the court of last resort of such state."

The Circuit Court of Appeals for the Sixth District affirmed "upon the ground and for the reasons stated in the opinion of the District Judge * * *."

We have thus far assumed that there is a conflict between the decisions in New York and the decisions in Michigan. Actually, the statutes of the two states

are quite dissimilar. The sections which immediately follow Section 36-a of the New York Lien Law make it perfectly plain that the New York statute was intended to confer substantive civil rights which the beneficiaries of the trust could enforce (Secs. 36-c, 36-d and 36-e of the Lien Law of the State of New York).

POINT II.

Petitioner's contentions on the merits.

Petitioner's arguments on the merits serve to emphasize that the Federal Courts in the Second and Sixth Circuits were merely applying state law, and that if there is any conflict at all, it is a conflict between the Lien Law of New York and the Lien Law of Michigan. Accordingly, petitioner has shown no ground for granting the writ.

Since petitioner has nevertheless, seen fit to submit a brief on the merits, we shall take the liberty of discussing certain of the points involved in the case. These have already been discussed at some length in the opinions of the Circuit Court (fols. 121-140, 170-180), the District Court (fols. 88-93), and the Referee (fols. 59-75), and we shall confine ourselves to very brief comment on certain of the contentions advanced in petitioner's brief.

Petitioner's Contention That the Trust Provisions of Section 36-a of the New York Lien Law Protect Only Those Sub-contractors Who Have Filed Liens.

Before the Referee and in the District Court petitioner argued that the Wickes Boiler Company, Inc. was not entitled to enforce the trust created by Section 36-a because it had not filed a notice of lien. On the original argument of the appeal in the Circuit Court, however, petitioner made no contention whatsoever based upon the fact that respondent had not filed a notice of lien. Accordingly, it was not until the reargument that this point was briefed by counsel and fully considered by the court.

Petitioner, at page 15 of its brief, makes an inaccurate and misleading statement as to the grounds for the Circuit Court's decision on this point. As we shall show presently, the refusal of the Court of Appeals in *New York Trap Rock Corp.* v. *National Bank of Far Rockaway,* 285 N. Y. 313, to approve the Appellate Division, 2nd Dept.'s, construction of the statute would have been sufficient ground for the Circuit Court's decision on the reargument. But the Circuit Court did not rely on that alone. It also relied on the decision of the Appellate Division, First Dept., in *Raymond Concrete Pile Co.* v. *Federation Bank & Trust Co.,* 261 App. Div. 25, and upon the express language of Section 36-a and the reports of the New York Joint Legislative Committee (fols. 175-179). It was perfectly apparent that the decision of the Appellate Division, Second Department, was an isolated departure from the generally accepted rule, and that it did not represent the law of New York (see, for example, *York Trim Corp.* v. *Ardley Trading Corp.,* 169 Misc. 656).

We might add that after the Second Department decision in *N. Y. Trap Rock Corporation* v. *National Bank of Far Rockaway* (*supra*), a motion for reargument was made to the Appellate Division, First Dept., in the *Raymond Concrete Pile* case, in reliance upon the Second Dept. decision. The Appellate Division, First Dept., denied the motion (*Raymond Concrete Pile Co.* v. *Federation Bank & Trust Co.*, 262 App. Div. 847).

But getting back to the Court of Appeals decision in the *N. Y. Trap Rock* case, there is a strong indication in the decision itself that the Court of Appeals disagreed with the Appellate Division's construction of the section in question. The Court of Appeals' affirmance was based on a procedural ground which the Appellate Division had not even mentioned in its decision. The effect of this procedural affirmance was to dismiss the complaint and to require the plaintiff to start a new action—this time in equity, rather than at law. It is difficult to believe that the Court of Appeals would have required the plaintiff to make this procedural change in the form of his action, if it had agreed with the Appellate Division that the plaintiff had no cause of action at all. Had it agreed with the Appellate Division on the substantive ground, the Court of Appeals certainly would have disposed of the case on that ground. It would not have required the plaintiff to correct a procedural defect, before throwing him out on the merits. Incidentally, the Court of Appeals decision to the effect that the construction of Section 25-a was not necessarily presented in the *New York Trap Rock* case, would seem to render the decision of the Appellate Division in that case nothing more than dictum.

Petitioner cites *Pauly* v. *Keebler,* 175 Misc. 428 (Petitioner's Brief, pp. 15-16). The statute construed in that case was expressly limited in its application "to persons entitled to a lien under this chapter * * *". The difference between such a statute and Section 36-a of the Lien Law requires little comment. The New York Statute contains no such limitation as the statute just referred to. In fact, as the Circuit Court points out, the New York Statute expressly covers certain persons who are not even permitted to file liens (fols. 177-179).

Petitioner neglects to mention the more resent Wisconsin case of *Murphy* v. *National Paving Co.,* 229 Wisc. 100, 281 N. W. 705. That case involved a statute which did not contain the restrictive language of the earlier statute, and it was there held that a sub-contractor could enforce the trust, even though he had not acquired a lien. Petitioner also neglects to mention the Wisconsin case of *Fox & Co.* v. *State,* 229 Wisc. 44, 281 N. W. 666, in which the court pointed out, at page 49:

> "The term 'claim' [which is the term used in both the N. Y. and Wisconsin trust statutes] is more comprehensive than 'lien' and includes nonlienable items, so long as they are germane to performing such contract upon the public work. The legislature evidently intended that the rights of those contributing their labor or materials to the public work should be protected above other creditors whose claims bear no relation to the public improvement."

Petitioner's Contention That Its Filing of a Petition of Arrangement Prior to Its Receipt of the Money from the Owner, Renders Section 36-a of the Lien Law Inoperative.

The proposition that a trustee in bankruptcy will not be bound by the rights and obligations which a statute creates unless the statute makes express reference to such trustee in bankruptcy, is indeed a novel one. It is only by virtue of his status as trustee, that the trustee in bankruptcy receives the money at all. He receives the money subject to the same trust which would be imposed against the bankrupt.

At the time of the filing of the petition for arrangement, the bankrupt had no absolute right to the money. All that the trustee inherits from the bankrupt is the bankrupt's right to receive the money as trustee. That is all the bankrupt had, and that is all the trustee gets. As Judge Leibell pointed out in his decision (fol. 90):

> "The filing of the petition under Ch. XI could not enlarge or clear the debtor's title to these funds."

The concept is elementary and is well stated in *Boise* v. *Talcott* (C. C. A. 2), 264 Fed. 61, as follows:

> "A trustee in bankruptcy takes the property of the bankrupt, not as an innocent purchaser, but as the debtor had it at the time of the petition, subject to all valid claims, liens and equities. *Zartman* v. *First National Bank,* 216 U. S. 134."

Clear it is therefore that the trustee cannot take the money and at the same time repudiate the bank-

rupt's obligation to receive that money as trustee. There is nothing in the language of Section 36-a itself which justifies any such result. It is difficult to see how the Legislature could have used very different language. It was imposing a trust and providing criminal penalties for the violation of that trust. The Legislature couldn't very well impose this trust obligation on the contractor until the money came into his hands. Naturally enough, therefore, the section says that "The funds received by a contractor" shall constitute trust funds "in the hands of such contractor". But it is nothing short of absurd to try to torture this perfectly natural language into an expression of intention to sweep aside the fundamental principles of bankruptcy law and to confer upon a trustee in bankruptcy a better title than that possessed by his bankrupt.

Petitioner refers to *Amicsite Construction Corp.* v. *Luciano Contracting,* 284 N. Y. 223. In that case the money was not in the hands of the contractor because it had not yet been paid to him and was still in the hands of the state. And that is what the court meant when it pointed out that Section 25-a had no application because the money was not "in the hands of the contractor". The court was not drawing any distinction between a contractor and his trustee in bankruptcy.

In an effort to show that a trustee in bankruptcy can sometimes get better rights than the bankrupt would have, petitioner at page 14 of its brief refers to the case of a conditional vendor who has failed to file a copy of his contract, as required by law. In such a case the contract, although valid as between the original parties, is held void as against a trustee

in bankruptcy. However, this result is based entirely upon Section 65 of the New York Personal Property Law, which expressly provides that an unfiled conditional sales contract shall be void as against the creditors of the conditional vendee.

Petitioner points out at pages 14-15 of its brief that the Bankruptcy Act gives a trustee in bankruptcy the rights of an attaching or judgment creditor. Petitioner is here referring to the 1910 amendment to Section 75 of the Bankruptcy Act. It is elementary that the sole purpose and effect of this amendment is to place the trustee in a position to attack unlawful transfers made by the bankrupt. As pointed out in *Horton* v. *Queens Co. Machinery Corp. Inc.,* 101 Misc. 31, at page 35:

> "This section [Sec. 75, formerly Sec. 47] does not deal with the title of the trustee to the bankrupt's property, but only with the trustee's duties. The provisions relating to title are contained in Sec. 70. The provisions of the amendment in question plainly deal only with the question of remedy or procedure. The reason for the adoption of this amendment and the objections sought to be accomplished by it are generally agreed to both by text writers and decisions. These are said to be to overcome the effect of the decisions like *York Mfg. Co.* v. *Cassell,* 201 U. S. 344; *Matter of N. Y. Economy Printing Co.,* 110 Fed. 514, and to enable the trustee to attack secret liens created or transfers made by bankrupts which otherwise could not be attacked. Collier on Bankruptcy, 9th Ed. (659-661)."

Petitioner's Contention That Section 36-a of the New York Lien Law Creates an Unauthorized Priority In Contravention of Section 64 of the Bankruptcy Act.

Petitioner asserts that respondent is claiming a "priority" and that Section 64 of the Bankruptcy Act recognizes only priorities created by United States Law and not priorities created by state law. If the argument is sound, then no trusts whatsoever would be recognized by the Bankruptcy Courts. Trusts are created either by agreement between the parties or by state law. They are not generally created by United States law.

Turning over trust money to the *cestui* of a trust is not the payment of a debt of a bankrupt estate, and Section 64 of the Bankruptcy Act relating to priorities has no application. The question of priorities can be involved only where unsecured creditors are claiming payment out of the general fund in the hands of the trustee. Trust funds aren't part of the bankrupt estate and the *cestui's* claim to the trust money is not the assertion of a priority under Section 64 of the Bankruptcy Act.

Petitioner suggests the possibility that state legislatures might create trusts in all kinds of situations to the prejudice of general creditors. Entirely apart from the constitutional prohibitions against the arbitrary creation of trusts, petitioner's argument is beside the point and should be addressed to Congress. A trust and a priority are two entirely different things, and the Bankruptcy Act as it now stands gives effect to trusts whether created by indenture or by State statute. Indeed, there would be serious question as to the power of Congress to refuse to give effect to trusts created by valid state statutes.

CONCLUSION.

There is no such conflict between the Circuit Courts for the Second and Sixth Circuits as warrants the granting of a writ of certiorari, and the application should be denied.

Respectfully submitted,

ALFRED B. NATHAN,
Counsel for Respondent.